

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
AVCG MANUFACTURING CORPORATION)

Appearances:

For Appellant: Donald T. Burns, Certified Public
Accountant

For Respondent: John S. Warren, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the protests of Avco Manufacturing Corporation to proposed assessments of additional corporation income tax in the amounts of \$1,280.34, \$8,066.80, \$4,754.64 and \$3,834.82 for the taxable years ended November 30, 1949, 1950, 1951 and 1952, respectively.

Appellant, a foreign corporation qualified to do business in California, had three divisions engaged in the manufacturing of electrical appliances. They were Crosley Division, American Kitchens Division and Bendix Home Appliances Division. All manufacturing was done outside of California. Although the headquarters of all of the divisions and most of their property and employees were out of the State, the first two divisions had offices in California and employees stationed here. Crosley Division, during the period in question, had between five and ten California employees. American Kitchens had between one and four employees here. The Bendix Division did not have an office in California, but an employee operating out of an office in Phoenix, Arizona, spent about twenty-five percent of his time in California. Some of the employees in the California offices of the other divisions spent approximately half of their time in neighboring states. The products of all divisions were sold to independent distributors, who, in turn, distributed them to retailers.

The employees working in California kept the distributors abreast of current improvements in Appellant's products and assisted them in the development of sales programs, service training and the introduction of new products. They sometimes called on retailers. Complaints of distributors

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and retailers were handled by the California employees, who made recommendations to the division headquarters regarding returns and allowances. The California employees did not take purchase orders. These were sent by the distributors directly to division headquarters and were filled by shipment from out of State.

In its returns, Appellant did not treat any sales as attributable to California for purposes of the sales factor in the income allocation formula composed of the factors of property, payroll and sales. The Franchise Tax Board determined that fifty percent of the sales to California distributors by the Crosley and American Kitchens Divisions and twenty-five percent of the sales to California distributors by the Bendix Division should be treated as California sales in the sales factor.

It is well established that the Franchise Tax Board has the authority, within reasonable limits, to originate and prescribe the formula to be used for the allocation for tax purposes of income of a corporation deriving income from sources within and without the State (El Dorado Oil Works v. McColgan, 34 Cal. 2d 731, app. dism. 340 U.S. 801, 885; Pacific Fruit Express Co. v. McColgan, 67 Cal. App. 2d 93). Such authority necessarily carries with it the authority to define the factors used in the formula. The Franchise Tax Board has defined the sales factor in Regulation 24301, Title 18 of the California Administrative Code, in part as follows:

"The sales or gross receipts factor generally shall be apportioned in accordance with employee sales activity of the taxpayer within and without the State ... Promotional activities of an employee are given some weight in the sales factor, "

The purpose of the sales factor in the allocation formula has been described by eminent authorities as being to serve as a balance against the other factors of property and payroll and to give recognition to the efforts of the taxpayer in obtaining customers and markets (Final Report of the Committee on Tax Situs and Allocation, 1951 Proceedings of the National Tax Association, p. 43; Altman & Keesling, Allocation of Income in State Taxation, Second Edition, 1950, p. 126). As Altman & Keesling put it:

"With this exception [that sales should not be apportioned to states or countries where the taxpayer is

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engaged in neither inter nor intra-state activities] sales should, so far as possible, be apportioned to the state where the markets are found, from which the business is received, or where the customers are located." (Op. cit. p. 128.)

The determination of the Franchise Tax Board that a substantial percentage of the sales to California distributors should be treated as California sales in the sales factor was in general alignment with its regulation and with the purpose of the sales factor as announced by the above authorities. It is obvious that the California employees were here to promote sales through their "missionary" activities. These activities were continuous and substantial. It is only reasonable to conclude that such extensive activities were responsible for a substantial portion of the company sales to California purchasers.

We conclude that the determination of the Franchise Tax Board was reasonably accurate and within its discretion.

O R D E R

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the protests of Avco Manufacturing Corporation to proposed assessments of additional corporation income tax in the amounts of \$1,280.34, \$8,066.80, \$4,754.64 and \$3,834.82 for the taxable years ended November 30, 1949, 1950, 1951 and 1952, respectively, be and the same is hereby sustained,

Done at Sacramento, California, this 16th day of December, 1959, by the State Board of Equalization.

Paul R. Leake, Chairman
John W. Lynch, Member
Richard Nevins, Member
George R. Reilly, Member
_____, Member

ATTEST: Dixwell L. Pierce, Secretary